

Report
of the
Examination of
Badger Mutual Insurance Company
Milwaukee, Wisconsin
As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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August 19, 2004

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Chairman, Financial Condition (E)
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Commissioners:

In accordance with the instructions of the Wisconsin Commissioner of Insurance a compliance examination has been made of the affairs and financial condition of:

BADGER MUTUAL INSURANCE COMPANY
Milwaukee, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Badger Mutual Insurance Company (BMIC or the company) was conducted in 1999 as of December 31, 1998. The current examination covered the intervening period ending December 31, 2003, and included a review of such 2004 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance. The actuary reviewed the adequacy of the company's loss and loss adjustment expense reserves. The actuary's results were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

The company was organized in 1887 as “Der Deutsche Gegenseitige Feuer Unterstuetzungs Verein” (The German Mutual Fire Insurance Society). The company was incorporated in Wisconsin on June 6, 1891, as the “Badger Mutual Fire Insurance Company.” The present name of the company, “Badger Mutual Insurance Company” was adopted in 1948.

In 2003, the company wrote direct premium in the following states:

Wisconsin	\$46,090,791	50.0%
Illinois	29,012,388	32.0%
Michigan	10,439,887	11.0%
Minnesota	<u>6,427,486</u>	<u>7.0%</u>
Total	<u>\$91,970,552</u>	<u>100.0%</u>

The company is licensed in Illinois, Iowa, Michigan, Minnesota and Wisconsin; there was no direct premium reported for Iowa.

The major products marketed by the company include commercial multiple peril, homeowners multiple peril, private passenger auto liability and physical damage. The major products are marketed through 1,002 independent agents representing 554 agencies.

The following table is a summary of the net insurance premiums written by the company in 2003. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	\$ 2,023,543	\$	\$ 108,241	\$ 1,915,302
Allied lines	1,161,796		59,995	1,101,801
Homeowners multiple peril	20,531,292		1,240,988	19,290,304
Commercial multiple peril	32,957,067		6,178,735	26,778,332
Inland marine	4,961			4,961
Worker's compensation	1,990,448		515,886	1,474,562
Other liability - occurrence	475,941		36,723	439,218
Private passenger auto liability	18,024,096		3,084,987	14,939,109
Commercial auto liability	15,509		2,966	12,543
Auto physical damage	14,785,898		1,750,552	13,035,346
Reinsurance - non-proportional assumed property		46,826		46,826
Reinsurance - non-proportional assumed liability		<u>47,066</u>		<u>47,066</u>
Total All Lines	<u>\$91,970,552</u>	<u>\$93,892</u>	<u>\$12,979,074</u>	<u>\$79,085,370</u>

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of ten members. Directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The outside board members currently receive a \$10,000 annual retainer; members of the Audit and Finance Committees receive a \$6,000 annual retainer. All members also receive \$500 for special meetings which are defined as any meeting in excess of four meetings per year.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Roy R. Bubeck Grafton, WI	President/CEO, BMIC	2006
Santino Cicero River Hills, WI	Executive, M&I Bank	2006
Ellis R. Herbon Hartland, WI	Attorney (Retired)	2005
Steven C. Klima Neenah, WI	Manager, Di Renzo Simonis Miller, LLC	2004
Sharon K. Kress Dubuque, IA	Investment Manager (Retired)	2005
Bartley L. Munson Sturgeon Bay, WI	Actuarial Consultant, Munson & Associates	2005
Richard A. Rusch Flat Rock, NC	Chairman (Retired), BMIC	2004
Robert W. Smith Grafton, WI	Assistant Corporate Controller, Johnson Controls Inc.	2006
David L. Springob Cedar Grove, WI	Chairman (Retired), Catholic Family Life Insurance	2004
Stuart H. Warrington Sheboygan, WI	Insurance Systems (Retired)	2005

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2003 Compensation
Roy Bubeck	President/CEO	\$443,417
Darrin Groendal	Vice President/Treasurer	123,323
David Kane	Vice President	73,997
James Kaufman	Vice President	120,184
Karen Kirk	Vice President/Secretary	113,453
Jerry Kramer	Vice President	116,462
Anthony Pyle	Vice President	126,170

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Finance Committee

Sharon K. Kress, Chair
Roy R. Bubeck
Richard A. Rusch
David L. Springob
Stuart H. Warrington

Audit Committee

Steven C. Klima, Chair
Ellis R. Herbon
Bartley L. Munson
Robert W. Smith

Compensation Committee

Richard A. Rusch, Chair
Ellis R. Herbon
Steven C. Klima
Sharon K. Kress
Barley L. Munson
Robert W. Smith
David L. Springob
Stuart H. Warrington

IV. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

The company assumes reinsurance from NAMIC Insurance Company for Directors and Officers, and Errors and Omissions liability policies: 0.88718% of 50% of the first \$1 million of each claim, and 0.88718% of 80% of \$4 million excess of \$1 million per claim.

Nonaffiliated Ceding Contracts

1. Type: Equipment Breakdown Liability
Reinsurer: The Hartford Steam Boiler Inspection and Insurance Company
Scope: Commercial Package
Coverage: 100%; liabilities not to exceed \$25,000,000 for any one accident.
Premium: Quarterly payments of estimated annual direct premiums earned less ceding commission, and adjusted annually at 90% of actual direct premium earned at year-end less 6% exclusion and ceding commission.
Commissions: 28%
Effective date: January 1, 2001
Termination: Continue in force until terminated by either party giving the other six months' prior notice in writing.
2. Type: First Multiple Line Excess of Loss Reinsurance
Reinsurer: GE Reinsurance Corporation 12%
Hannover Ruckversicherungs – AG 38%
Swiss Reinsurance America Corp. 50%
Scope: Property and Casualty, including Worker's Compensation
Retention: Property business - \$225,000 per risk
Casualty business - \$225,000 per loss occurrence
Coverage: Property - \$775,000 each and every risk, in excess of \$225,000, subject to \$2,325,000 any one loss occurrence and to an annual aggregate limit of \$2,325,000 in respect of acts of terrorism.
Casualty - \$775,000 each and every loss occurrence, in excess of \$225,000, and further subject to an aggregate limit of \$775,000 in respect of acts of terrorism.

- Premium: Annual deposit premium of \$5,849,200 payable in quarterly installments of \$1,462,300 and adjusted annually at a gross rate of 7.429% of Gross Net Earned Premium Income (GNEPI) with an annual minimum premium of \$4,679,360.
- Commissions: 30%
- Effective date: January 1, 2004
- Termination: Continuous until cancellation at any January 1 anniversary by either party given 90 days' notice.
3. Type: Second Multiple Line Excess of Loss Reinsurance
- Reinsurer: GE Reinsurance Corporation 40%
Hannover Ruckversicherungs – AG 10%
Swiss Reinsurance America Corp. 50%
- Scope: Property and Casualty, excluding Worker's Compensation
- Retention: \$1,000,000
- Coverage: Property - \$3,000,000 each and every risk, subject to \$6,000,000 any one loss occurrence and \$6,000,000 in the aggregate in respect of acts of terrorism.

Casualty - \$2,000,000 each and every loss occurrence subject to an aggregate of \$4,000,000 in respect of acts of terrorism.
- Premium: Annual deposit premium of \$952,200 payable in quarterly installments of \$230,050 and adjusted annually at a gross rate of 1.243% GNEPI and subject to an annual minimum premium of \$761,760.
- Commissions: 30%
- Effective date: January 1, 2004
- Termination: Continue in force until cancellation subject to 90 days' notice of cancellation at any January 1 anniversary by either party.
4. Type: First Workers' Compensation Excess of Loss Reinsurance
- Reinsurer: Midwest Employers Casualty Company
- Scope: Worker's Compensation
- Retention: \$1,000,000 ultimate net loss each and every occurrence.
- Coverage: \$9,000,000 ultimate net loss each and every occurrence.
- Premium: Minimum and deposit of \$181,800 payable in quarterly installments of \$45,450 and adjusted on December 31 at a 9% rate base on GNEPI.

- Effective date: January 1, 2004
- Termination: Continue in force until cancellation subject to 90 days' notice of cancellation at any January 1 anniversary.
5. Type: Casualty Excess of Loss Reinsurance Agreement
- Reinsurer: Swiss Reinsurance America Corporation
- Scope: Worker's Compensation
- Retention: \$10,000,000 ultimate net loss each and every occurrence.
- Coverage: \$5,000,000 any one occurrence
\$10,000,000 any one life
- Premium: Deposit premium of \$265,300 payable in quarterly installments of \$66,325 and adjusted annually at 12.48% of earned premium and subject to a minimum premium of \$212,240.
- Effective date: January 1, 2004
- Termination: Continue in force until cancellation subject to 90 days' notice of cancellation at any January 1 anniversary by either party.
6. Type: First Layer Property Catastrophe Excess of Loss
- Reinsurer: Domestic Placement
- | | |
|---|-----|
| Arch Reinsurance Company | 25% |
| GE Reinsurance Corporation | 25% |
| Platinum Underwriters Reinsurance, Inc. | 25% |
- European Placement
- | | |
|-------------------------------|-----|
| R+V Versicherung AG | 15% |
| Hannover Ruckversicherungs AG | 10% |
- Scope: Property including Automobile Physical Damage
- Retention: \$1,175,000
- Coverage: \$2,825,000 any one loss occurrence
\$5,650,000 for all peril
- Premium: Annual deposit of \$1,040,000 paid in quarterly installment of \$260,000 and adjusted annually at 2.33% GNEPI and subject to an annual minimum premium of \$832,000.
- Effective date: January 1, 2004, to December 31, 2004, both days inclusive.
- Termination: Under any part of Section I A of the contract upon written notice.
7. Type: Second Catastrophe Excess of Loss Reinsurance

Reinsurer:	<u>Domestic Placement</u> Arch Reinsurance Company 20% Mapfre Reinsurance Corporation 15% Platinum Underwriters Reinsurance, Inc. 25% QBE Reinsurance Corporation 10% <u>European Placement</u> Hannover Ruckversicherungs AG 20% R+V Versicherung AG 10%
Scope:	Property business including Automobile Physical Damage
Retention:	\$4,000,000
Coverage:	\$6,000,000 each and every loss occurrence \$12,000,000 all perils
Premium:	\$330,000 payable in \$82,500 quarterly installments. Rate adjusted of .74% GNEPI at December 31 and subject to a minimum premium of \$264,000.
Effective date:	January 1, 2004, to December 31, 2004, both days inclusive.
Termination:	Under any part of Section I A of the contract upon written notice.
8. Type:	Third Catastrophe Excess of Loss Reinsurance
Reinsurer:	<u>Domestic Placement</u> Arch Reinsurance Company 20% Mapfre Reinsurance Corporation 15% QBE Reinsurance Corporation 10% <u>European Placement</u> Hannover Ruckversicherungs AG 30% Sirius International Insurance Corporation 10% R+V Versicherung AG 15%
Scope:	Property business including Automobile Physical Damage
Retention:	\$10,000,000
Coverage:	\$10,000,000 each and every occurrence. \$20,000,000 all perils
Premium:	Deposit premium of \$200,000 payable in \$50,000 quarterly installments. Rate adjusted of .45% GNEPI at December 31 and subject to a minimum premium of \$160,000.
Effective date:	January 1, 2004, to December 31, 2004, both days inclusive.
Termination:	Under any part of Section IA of the contract upon written notice.

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Badger Mutual Insurance Company
Assets
As of December 31, 2003

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$ 95,923,719	\$	\$ 95,923,719
Stocks:			
Common stocks	2,737,981		2,737,981
Real estate:			
Occupied by the company	346,800		346,800
Properties held for the production of income	170,533		170,533
Cash	(1,148,342)		(1,148,342)
Short-term investments	7,956,474		7,956,474
Investment income due and accrued	1,115,635		1,115,635
Uncollected premiums and agents' balances in course of collection	1,534,127		1,534,127
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	10,828,492		10,828,492
Reinsurance:			
Amounts recoverable from reinsurers	168,336		168,336
Current federal and foreign income tax recoverable and interest thereon	610,339		610,339
Net deferred tax asset	4,044,093	725,737	3,318,356
Electronic data processing equipment and software	262,744		262,744
Furniture and equipment, including health care delivery assets	20,170	20,170	
Other assets nonadmitted:	5,389	5,389	
Write-ins for other than invested assets:			
Prepaid pension	<u>734,366</u>	<u>734,366</u>	<u> </u>
Total Assets	<u>\$125,310,855</u>	<u>\$1,485,662</u>	<u>\$123,825,193</u>

Badger Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2003

Losses		\$ 33,913,637
Loss adjustment expenses		8,103,604
Commissions payable, contingent commissions, and other similar charges		3,218,235
Other expenses (excluding taxes, licenses, and fees)		1,034,153
Taxes, licenses, and fees (excluding federal and foreign income taxes)		1,189,386
Unearned premiums		35,893,067
Advance premium		1,382,749
Dividends declared and unpaid:		
Policyholders		1,193
Ceded reinsurance premiums payable (net of ceding commissions)		776,428
Amounts withheld or retained by company for account of others		253,444
Write-ins for liabilities:		
New business pending		<u>200,449</u>
Total Liabilities		<u>85,966,345</u>
Write-ins for special surplus funds:		
Non-assessable guarantee funds	\$ 1,000,000	
Unassigned funds (surplus)	<u>36,858,848</u>	
Surplus as Regards Policyholders		<u>37,858,848</u>
Total Liabilities and Surplus		<u>\$123,825,193</u>

Badger Mutual Insurance Company
Summary of Operations
For the Year 2003

Underwriting Income

Premiums earned		\$73,609,953
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Deductions:

Losses incurred	\$39,963,603	
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Loss expenses incurred	7,157,203	
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Other underwriting expenses incurred	<u>23,654,714</u>	
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Total underwriting deductions		<u>70,775,520</u>
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Net underwriting gain or (loss)		<u>2,834,433</u>
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Investment Income

Net investment income earned	2,654,241	
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Net realized capital gains or (losses)	<u>1,917,296</u>	
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Net investment gain or (loss)		<u>4,571,537</u>
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Other Income

Net gain or (loss) from agents' or premium balances charged off	(2)	
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Finance and service charges not included in premiums	<u>483,393</u>	
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Total other income		<u>483,391</u>
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Net income (loss) before dividends to policyholders and before federal and foreign income taxes		<u>7,889,361</u>
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Dividends to policyholders		<u>22,424</u>
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Net income (loss) after dividends to policyholders but before federal and foreign income taxes		7,866,937
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Federal and foreign income taxes incurred		<u>2,678,356</u>
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Net Income		<u>\$ 5,188,581</u>
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Badger Mutual Insurance Company
Cash Flow
For the Year 2003

Premiums collected net of reinsurance		\$77,000,783
Net investment income		3,447,214
Miscellaneous income		<u>483,391</u>
Total		80,931,388
Benefit and loss related payments	\$33,046,394	
Net transfers to separate, segregated accounts and protected cell accounts		
Commissions, expenses paid, and aggregate write-ins for deductions	27,642,515	
Dividends paid to policyholders	30,305	
Federal and foreign income taxes paid (recovered)	<u>3,288,855</u>	
Total deductions		<u>64,008,069</u>
Net cash from operations		16,923,319
Proceeds from investments sold, matured, or repaid:		
Bonds	\$41,858,220	
Stocks	827,922	
Other invested assets	5,809	
Net gains (losses) on cash and short-term investments	<u>(15,190)</u>	
Total investment proceeds	42,676,761	
Cost of investments acquired (long-term only):		
Bonds	50,653,254	
Stocks	2,882,684	
Real estate	83,795	
Miscellaneous applications	<u>(17,050)</u>	
Total investments acquired	<u>53,602,683</u>	
Net cash from investments		(10,925,922)
Cash from financing and miscellaneous sources:		
Other cash provided (applied)	<u>(922,891)</u>	
Net cash from financing and miscellaneous sources		<u>(922,891)</u>
Reconciliation		
Net change in cash and short-term investments		5,074,506
Cash and short-term investments, December 31, 2002		<u>1,733,626</u>
Cash and short-term investments, December 31, 2003		<u>\$ 6,808,132</u>

Badger Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2003

Assets		\$123,825,193
Less security surplus of insurance subsidiaries		0
Less liabilities		<u>85,966,345</u>
Adjusted surplus		37,858,848
Annual premium:		
Lines other than accident and health	\$79,062,946	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million)		<u>15,812,589</u>
Compulsory surplus excess (or deficit)		<u>\$ 22,046,259</u>
Adjusted surplus (from above)		\$ 37,858,848
Security surplus: (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million, with a minimum factor of 110%)		<u>21,821,372</u>
Security surplus excess (or deficit)		<u>\$ 16,037,476</u>

Badger Mutual Insurance Company
Reconciliation and Analysis of Surplus (in thousands)
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2003	2002	2001	2000	1999
Surplus, beginning of year	\$32,701,300	\$29,992,446	\$24,111,192	\$23,513,089	\$20,946,021
Net income	5,188,581	2,640,244	3,209,834	424,867	2,528,547
Net unrealized capital gains or (losses)	216,071	(282,763)	128,899	145,123	54,875
Change in net deferred income tax	394,219	42,445	44,000		
Change in non-admitted assets	(641,324)	308,926	(1,139,953)	(10,887)	1,646
Change in excess statutory reserve over statement reserve				39,000	(18,000)
Cumulative effect of changes in accounting principles			<u>3,638,476</u>		
Surplus, end of year	<u>\$37,858,848</u>	<u>\$32,701,300</u>	<u>\$29,992,446</u>	<u>\$24,111,192</u>	<u>\$23,513,089</u>

**Badger Mutual Insurance Company
Insurance Regulatory Information System
For the 5-Year Period Ending December 31, 2003**

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	2003	2002	2001	2000	1999
#1	Gross Premium to Surplus	243.0%	241.0%	226.0%	230.0%	224.0%
#2	Net Premium to Surplus	209.0	202.0	204.0	210.0	194.0
#3	Change in Net Writings	20.0	8.0	21.0	11.0	3.0
#4	Surplus Aid to Surplus	1.0	1.0	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	92.0	94.0	95.0	95.0	100.0*
#6	Investment Yield	2.7*	3.6*	4.4*	5.0	4.5*
#7	Change in Surplus	16.0	10.0	24.0	4.0	11.0
#8	Liabilities to Liquid Assets	70.0	69.0	70.0	71.0	70.0
#9	Agents' Balances to Surplus	4.0	4.0	4.0	5.0	4.0
#10	One-Year Reserve Development to Surplus	5.0	1.0	-7.0	-6.0	-22.0
#11	Two-Year Reserve Development to Surplus	8.0	-5.0	-5.0	-23.0	-13.0
#12	Estimated Current Reserve Deficiency to Surplus	-4.0	-3.0	15.0	1.0	-20.0

The company has an exceptional ratio in #6, Investment Yield, for four of the last five years. This exception is largely due to the decline in interest rates, and that the company invests in Treasury and municipal bonds which have a lower yield. The company's "two-year overall operating ratio" for 1999 was 100%, which is in the unusual range. The ratio was above the industry levels due to a 22% increase in incurred losses for the 1998 business year. The higher incurred losses was related to several windstorms in the company's underwriting territory during 1998.

Growth of Badger Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2003	\$123,825,193	\$85,966,345	\$37,858,848	\$5,188,581
2002	103,584,924	70,883,622	32,701,300	2,640,244
2001	90,789,192	60,796,746	29,992,446	3,209,834
2000	77,465,219	53,354,027	24,111,192	424,867
1999	74,683,201	51,170,112	23,513,089	2,528,547
1998	72,215,616	51,269,595	20,946,021	(712,867)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2003	\$92,064,443	\$79,085,370	\$73,609,953	64.0%	32.1%	96.1%
2002	78,863,031	65,919,381	62,242,192	68.7	32.6	101.3
2001	67,691,634	61,206,834	56,055,900	68.2	33.0	101.2
2000	55,399,902	50,741,730	48,466,217	74.2	32.0	103.2
1999	52,560,594	45,606,438	45,531,470	69.5	31.0	100.5
1998	52,018,746	44,389,041	43,543,443	85.0	30.0	115.0

The company has reported net income for every year under the examination. The company's gross written premium averaged a 16.7% increase for each of the past two years. The company's loss and expense ratio has remained fairly consistent over the past five years, with 2003 showing a lower loss ratio and the only combined ratio under 100%. Since 1998, the business lines of homeowners and commercial multiple peril increased 85% and 167%, respectively. The growth in premium is a result of increases in rates as well as considerable growth in the book of business written by the company. The company's private automobile liability business increased 20% in the same period.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2003, is accepted.

Examination Reclassifications

	Debit	Credit
Amounts withheld or retained by company for account of others	\$225,967	\$
Escheatable funds		225,967
New business pending	200,449	
Remittances and items not allocated	<u> </u>	<u>200,449</u>
Total reclassifications	<u>\$426,416</u>	<u>\$426,416</u>

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were six specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. **Custodial Agreement**—It is again recommended that the company fully comply with s. 610.23, Wis. Stat., by executing proper custodial agreements containing satisfactory safeguards and controls in accordance with the NAIC Examiners Handbook.

Action—Compliance

2. **Preferred Stock**—It is recommended that the company report the annual statement value of preferred stock in accordance with the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

Action—Compliance

3. **Short-term Investments**—It is recommended that the company report money market funds in accordance with the NAIC Annual Statement Instructions Property and Casualty and Purpose and Procedures Manual of the NAIC Securities and Valuation Office.

Action—Compliance

4. **Amounts Withheld or Retained by Company for Account of Others**—It is recommended that the company report all underwriting and investment taxes, licenses and fees in accordance with the NAIC Annual Statement Instructions Property and Casualty.

Action—Compliance

5. **Reinsurance**—It is recommended that the company report all reinsurance voluntary pools and association connected with Schedule F-Part 1 and Schedule F-Part 3 in accordance with the NAIC Annual Statement Instructions Property and Casualty.

Action—Compliance

6. **Reinsurance Recoverables**—It is recommended that the company report anticipated reinsurance recoverables on unpaid losses and loss adjustment expenses in accordance with the NAIC Annual Statement Instructions Property and Casualty.

Action—Compliance

Summary of Current Examination Results

Retention of Records

The company was unable to provide the examiners with documentation to support a significant portion of the balance for the “Amounts withheld or retained by company for account of others.” Company personnel were unsure of what individual liabilities were included in this balance. In addition, the company was unable to provide the examination team with requested data files on a timely basis in accordance with s. Ins 6.80, Wis. Adm. Code. It is recommended that the company take steps to ensure that proper records are maintained and available within a reasonable amount of time, pursuant to the requirements of s. Ins 6.80, Wis. Adm. Code.

Advance Premium

The “Premiums received in advance” balance reported on the annual statement is calculated by the company’s computer system. The computer system does not produce a detailed listing of the reported balance. Without a detail listing the examiners were unable to identify if the entire balance was advance premium or if other accounts were included. The company does not appear to have procedures in place to be able to identify policies that make up this balance. It is recommended that the company periodically reconcile “Premiums received in advance” to detailed reports.

Remittances and Items not Allocated

The company reported “New Business Pending” as a write-in liability on the annual statement. This amount was comprised of a fund that collects premium for new policies which are being reviewed by the company prior to issuance or rejection. In accordance with Accounting Practices and Procedures Manual SSAP No. 67, paragraph 9 a and NAIC Annual Statement Instructions – Property & Casualty, “Remittances and items not allocated” includes premium payments received with the application for policies which have not yet been issued. The company incorrectly reported the balance as a write in amount instead of “Remittances and items not allocated” on the annual statement. It is recommended that the company report “Remittances and items not allocated” in accordance with the NAIC Annual Statement Instructions - Property &

Casualty. A reclassification has been made in the “Reconciliation of Surplus Per Examination” section of this report to reflect the above finding.

Unclaimed Funds

The company reported unclaimed funds within the “Amounts withheld for others” balance on the annual statement. According to the NAIC Annual Statement Instructions - Property & Casualty, uncashed drafts and checks that are pending escheatment to a state should be listed separately under Aggregate Write-ins for Liabilities. It is recommended that the company properly record its escheat fund liability in future Annual Statement filings in accordance with the NAIC Annual Statement Instructions - Property & Casualty. A reclassification has been made in the “Reconciliation of Surplus Per Examination” section of this report to reflect the above finding.

VII. CONCLUSION

As of December 31, 2003, Badger Mutual Insurance Company had total assets of \$123,825,193, total liabilities of \$85,966,345 and policyholders' surplus of \$37,858,848. The company continues to grow steadily, and reported an increase to surplus during each year under examination.

The company complied with all of the recommendations from the previous report. The current examination resulted in five recommendations relating to the company's record retention, reporting items in accordance with the annual statement instructions and reconciling account balances. No adjustments to surplus were made as a result of this examination.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Retention of Records—It is recommended that the company take steps to ensure that proper records are maintained and available within a reasonable amount of time, pursuant to the requirements of s. Ins 6.80, Wis. Adm. Code.
2. Page 21 - Advance Premium—It is recommended that the company periodically reconcile “Premiums received in advance” to detailed reports.
3. Page 21 - Remittances and Items not Allocated—It is recommended that the company report “Remittances and items not allocated” in accordance with the NAIC Annual Statement Instructions - Property & Casualty.
4. Page 22 - Unclaimed Funds—It is recommended that the company properly record its escheat fund liability in future Annual Statement filings in accordance with the NAIC Annual Statement Instructions - Property & Casualty.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
John Litweiler	Insurance Examiner
Sheur Yang	Insurance Examiner
Elena Vetrina	Insurance Examiner
Tim Vande Hey	Examiner - Advanced

Respectfully submitted,

Sarah M. Haeft
Examiner-in-Charge